

Analysis of
Business
Trends Plus
Selected
Financial
Indicators

Inflation At Bay

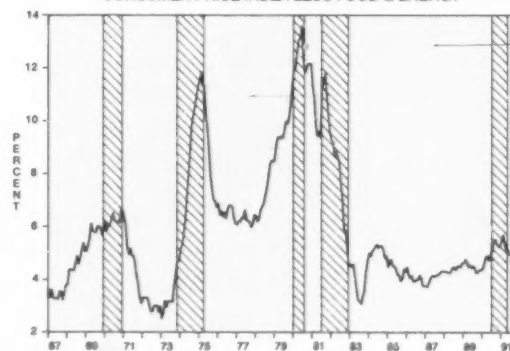
One of the more persistent, if needlessly exaggerated, concerns overhanging the financial markets is that any business recovery will generate higher rates of inflation. For notwithstanding the moribund state of industrial commodity prices and the lethargic pace of wage growth, virtually every sign of a pickup in economic activity, while applauded on Main Street, is greeted with dismay on Wall Street. Largely for this reason, long-term interest rates have been marching to the beat of their own drummer, trending higher in recent weeks, while turning a blind eye to all indications that this will be a tepid business rebound at best, and that the inflation rate itself has actually been slowing rather than accelerating. Also being ignored is the likelihood that some of the best inflation news may be yet to come. During the initial stages of recovery, productivity growth usually outpaces earnings growth, capping both unit labor costs and subsequent price pressures.

At this juncture, the trend toward diminished inflation momentum is becoming well established. According to the Labor Department, consumer prices rose by a paltry 0.2 percent in June, one of the slowest monthly increases so far this year. This brought the 12-month change in the consumer price index to 4.6 percent, well below the six percent plus posted last fall. Over the past three months, price performance has been even more benign. Consumer prices rose at about a three percent annual rate in the second quarter; they were rising at a 4½ percent annual clip in the second quarter of last year. And, perhaps even more important, the so-called "core" rate of inflation, which nets out the swings in food and energy prices, seems to be yielding to the subdued business environment. These prices have increased by 4.9 percent over the past year, the slowest year-over-year rise since the spring of last year.

The favorable trends in consumer prices are at least partially reflective of the even more noteworthy fading of producer price pressures. In June, for example, producer prices for finished

goods declined, the third monthly drop so far this year. This brought the year-over-year rise to just a shade under 3¼ percent, or less than half the rate of rise being posted last fall. In fact, producer price inflation at the earlier stages of production—so-called pipeline inflation—has largely evaporated. At the intermediate level of production, producer prices have increased by only one percent over the past year, while crude goods prices, the cost of materials just entering the production stream, have dropped by 1.6 percent over the past year.

12-MONTH PERCENT CHANGE IN
CONSUMER PRICE INDEX LESS FOOD & ENERGY



Source: Bureau of Labor Statistics

Favorable Influences

Several factors account for the recent string of good inflation rate numbers. For one thing, industrial commodity prices are behaving atypically at this stage of the business cycle. In the past, the onset of recovery and quickening production schedules have pushed sensitive industrial commodity prices decidedly higher. This time around, quite the opposite is occurring: These prices seem to be in nonstop decline, and have fallen by better than 12 percent during the past year.

For another, the seven percent jobless rate and repeated rounds of vigorous corporate cost-cutting are restraining the growth of wages and salaries—muting not only supply-side cost pressures, but also limiting the wherewithal of consumers to step up spending, potentially fueling demand-side price pressures. According to the Labor Department's Employment Cost In-

Manufacturers
Hanover
Economics
Department
17/270

dex—the most comprehensive gauge of compensation trends—wage and salaries growth throughout the private sector has been slowing for a year. Even the torrid pace of benefit increases has ebbed, stemming, and recently reversing the rise of overall compensation costs. Since these costs account for some two-thirds of all manufacturing costs, the noticeably slower ascent of compensation costs is keeping a lid on per unit costs. Not surprisingly, household personal income in the past year has taken a beating; after adjustment for inflation, personal income has registered one of the largest recession-related contractions on record. (Financial Digest—June 17, 1991).

More Progress To Come

Slumping commodity prices, restrained compensation cost increases and eroding real incomes all bode well for the inflation outlook. So, too, does the current stage of the business cycle. For rather than generating a quick uptick in inflation, the initial stages of recovery do the opposite, and are usually accompanied by lower rates of inflation. This is because recoveries boost output much more quickly than either the workforce or earnings, translating into productivity improvements and lower per unit costs. As shown in the chart, the inflation rate continues to decelerate after the trough of a business downturn, adding to the improvements which

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits \$100,000 or more Weekly Reporting Banks	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (7/10/91)	189,407	- 611	- 28,095
New York City (7/17/91)	31,899	+ 50	- 7,720
Commercial Paper (7/17/91)	539,077	- 4,165	- 3,556

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
Weekly Reporting Large Commercial Banks	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (7/10/91)	307,035	- 1,725	- 14,861
New York City (7/17/91)	55,297	+ 713	- 2,381
Total Loans and Leases Gross Adjusted			
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (7/10/91)	1,032,176	- 4,655	+ 20,354
New York City (7/17/91)	171,393	+ 568	- 11,651

Financial Markets

	Friday 7/26/91	Change Since	
		Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Billst	5.72%	+ .01	- 2.03
180-Day Billst	5.93	- .03	- 1.85
Longest Billst	6.22	- .01	- 1.55
Recent Issues:			
6½s 7/31/93 (When Issued)	6.84	NA	
7½s 7/31/96 (When Issued)	7.81	NA	
8s 5/15/01	8.20	- .08	
8½s 5/15/21	8.39	- .08	
Municipals:			
Bond Buyer—20 Bond Index* (7/25/91)	7.00%	- .04	- .15
Blue List Total (\$ Million)	\$1,214	+ \$ 42	+ \$100
30-Day Visible Supply (\$ Million)	\$2,086	- \$782	+ \$770
Total	\$3,300	- \$740	+ \$870
Corporates:			
Moody's Aa Composite (7/25/91)	9.19%	- .08	- .27
30-Day Visible Supply (\$ Million)	\$ 325	- \$200	+ \$ 75
Stocks:			
Dow-Jones Averages:			
Industrials	2,972.50	- 43.82	+ 73.98
Transportation	1,204.51	- 13.58	+ 69.84
Utilities	202.97	+ 2.89	- .38
65 Stocks	1,061.89	- 10.32	+ 34.61
N.Y.S.E. Composite Index	208.78	- 1.85	+ 15.46
N.Y.S.E. Avg. Daily Vol. for Week (000's)	148,129	- 36,469	- 23,841

*34% Taxable equivalent 10.61%.

† Bond equivalent.

International Rates

	Friday 7/26/91	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	5.69%	5.75%
1 month	5.88	5.94
3 month	5.94	6.00
6 month	6.19	6.31
1 year	6.50	6.69

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/26/91)	Currency Per U.S. \$	Week Ago
Belgium	35.78	36.22
Canada	1.1497	1.1565
France	5.9100	5.9735
Germany	1.7345	1.7605
Italy	1296.70	1311.50
Japan	137.80	136.99
Mexico	3033.40	3030.20
Netherlands	1.9565	1.9835
South Korea	711.37	717.47
Switzerland	1.5160	1.5269
Taiwan	26.63	26.70
U.K.*	1.6935	1.6784

*U.S. \$ per U.K. pound

MH TRADE- WEIGHTED DOLLAR (7/26/91)	Change Since Week Ago	2/27/85
(Adjusted for Inflation)	-0.5	-10.2%

occur during recessions themselves.

In the wake of the four preceding recessions, for example, the "core" rate of consumer price inflation has averaged 5.9 percent during the first year of recovery, two full percentage points lower than the average rate of inflation prevailing during the year immediately prior to the business trough. If the bond market would shed its selective myopia toward each and every sign of economic brightening, and adopted a more discerning view, it might welcome the prospect of a business rebound and the inflation benefits to come, rather than mistakenly assume that price pressures will immediately resume.

In this environment, any sustained ascent of long-term interest rates would seem to run counter to likely inflation performance. To be sure, this does not mean that it won't happen, since the financial markets have to wrestle with an avalanche of new Treasury offerings for the foreseeable future. But, unless the interest rate structure drops in line with the ebbing of inflation, the deficit will be financed at increasingly attractive real interest rates. This implies that the enormous Federal credit appetite can be met without necessarily pushing long-term interest rates any higher for quite some time, especially if inflation behaves as it has in the past.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/24/91	\$ Change Since Week Ago Year Ago	
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	257.020	- 1.044	+18.884
Loans to Depository Inst.		+ .043	- .512
Float	.353	- .056	- .464
Total Reserve Bank Credit	292.535	- 1.479	+13.766
Treasury Deposits with			
Federal Reserve Banks	6.033	- .612	+ .951
Currency in Circulation	292.895	- 1.421	+24.432
Gov'ts held for Foreign Acct.			
by F.R. Banks (End-of-Week)	243.127	+ .175	+16.729
Member Bank Reserves:	7/24/91		
Total Reserves Held	50.404	- .861	- 8.633
Excess (Deficiency)	.886	- .003	+ .001
Net Free Reserves	.422	+ .129	+ .071

Monetary Aggregates †

		‡ % Change Since 3 Months Ago* Year Ago	
M1 (7/15/91)	857.5	+ 6.2	+ 5.9
M2 (7/15/91)	3,390.5	+ 0.7	+ 3.3
M3 (7/15/91)	4,153.3	- 2.1	+ 2.0
Domestic Nonfinancial Debt (1st Q'91)	10,634.2	+ 2.8	+ 5.5

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/26/91	3 Months	6 Months	1 Year
* U.S. Treasury Bills	5.71%	5.93%	6.21%
* Federal Agencies	5.90	6.00	6.40
* Municipal Notes—High Grade (34% Taxable Equivalent)	6.44	6.82	7.12
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	5.96	6.15	5.50
‡ Finance Company Paper—Prime		‡ Bankers' Acceptances	
5-14 days	5.65%	Aug.	5.80%
15-29 days	5.75	Sep.	5.80
30-59 days	5.83	Oct.	5.80
60-89 days	5.85	Nov.	5.80
90-179 days	5.70	Dec.	5.82
180-239 days	6.03	Jan.	5.87
240-270 days	6.05		
‡ Industrial Paper—Prime		† Federal Funds	
30-89 days	5.84%	Effective Rate	5.69%
90-120 days	5.87		

‡ Discount basis.

* Subject to availability.

† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'91n	\$ 5,621	\$ 5,558	\$ 5,443
Gross National Product (1982 Dollars)*	2nd Q'91n	\$ 4,128	\$ 4,124	\$ 4,155
Percent Change, Annual Rate	2nd Q'91n	+ 0.4	- 2.8	+ 0.4
Change in Consumer Prices*	Jun '91n	2.4%	3.6%	7.2%
Change in MH Cost of Living Index*	Jun '91n	6.0%	2.4%	7.2%
Change in Producer Prices*	Jun '91	- 3.6%	7.2%	0.0%
Civilian Employment (Thousands of Persons) †	Jun '91	116,884	116,591	118,237
Unemployment as % of Civilian Labor Force †	Jun '91	7.0%	6.9%	5.3%
Personal Income*	May '91	\$ 4,779	\$ 4,755	\$ 4,621
Leading Indicators Composite Index (1967=100) †	May '91	143.1	142.0	146.0
Industrial Production Index (1977=100) †	Jun '91n	106.9	106.2r	110.1
Net Change in Consumer Installment Credit †	May '91	- \$ 0.63	\$ 1.18	\$ 1.78
U.S. Merchandise Trade Balance †	May '91n	- \$ 4.57	- \$ 4.51r	- \$ 8.15
Plant and Equipment Expenditures*	3rd Q'91	\$ 553.5(a)	\$ 544.2(a)	\$ 534.9
Private Housing Starts (Thousands of Units)*	Jun '91n	1,040	989r	1,187
New Construction Expenditures*	May '91	\$ 403.1	\$ 406.6	\$ 451.1r
Total Business Inventories †	May '91n	\$ 812.5	\$ 816.9r	\$ 816.7r
Total Business Sales †	May '91n	\$ 536.4	\$ 530.9r	\$ 540.4r

* Seasonally adjusted annual rate.

† Seasonally adjusted.

n-Newly reported figure.

r-Revised.

a-Anticipated.

CHEMICAL BANKING
Corporation

**MANUFACTURERS
HANOVER**

A peach of an idea for the Big Apple

(and fruitful for America, too).

Why not make a bank that would...

- Have 50% more branches than its nearest competitor in the New York metropolitan area;
- Have the largest market share of consumers, small businesses and mid-size companies in the New York metropolitan area;
- Rank first in primary banking relationships with U.S. corporations;
- Have 7 million credit card holders, ranking 6th in the nation;
- Be a world leader in corporate finance, foreign exchange trading, and interest rate and currency swaps, as well as the full range of operating services;
- Be able to invest in professional talent, technology and new products on a scale its predecessors could never approach;
- Be the second largest bank in America, with \$135 billion in assets, \$7.5 billion in shareholders' equity and \$60 billion in core deposits;
- Be the leading corporate bank in Texas, through Texas Commerce Bancshares, with a significant share in the state's consumer banking market;
- Have 132 and 92 branches in the fast-growing New Jersey and Texas markets, respectively, providing a good head start on nationwide banking;
- Be able to compete head-on with any financial institution, anywhere in the world;
- Serve its customers better as a result of these strengths—offering more products, backed by the best technology, and much stronger competitive muscle?

That's why we're merging today's Chemical and Manufacturers Hanover.
How could we resist such a peach of an idea?


John F. McGinnis
Chairman and CEO—Designate


Walter V. Shuler
President and CEO—Designate

The new **CHEMICAL BANKING** Corporation



**MANUFACTURERS
HANOVER**

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

First Class
U.S. Postage
PAID
Manufacturers
Hanover

00463000024182 C 939 CONGR0001
CONGRESSIONAL INFO SERVICE
ATTN: SRI
4520 EAST-WEST HWY
BETESDA, MD 20814

**Financial
Digest**

